VZCZCXRO7032
RR RUEHRG
DE RUEHBR #1417/01 3021849
ZNR UUUUU ZZH
R 281849Z OCT 08
FM AMEMBASSY BRASILIA
TO RUEHC/SECSTATE WASHDC 2750
INFO RUEHRI/AMCONSUL RIO DE JANEIRO 6804
RUEHSO/AMCONSUL SAO PAULO 2979
RUEHRG/AMCONSUL RECIFE 8637

UNCLAS SECTION 01 OF 02 BRASILIA 001417

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DEPT OF TREASURY FOR JHOEK, BONEILL

E.O. 12958: N/A
TAGS: ECON EFIN EINV ETRD BR
SUBJECT: Brazil Enacts Preventive Measures to Address Global
Downturn

REF: (A) SAO PAULO 486 (B) SAO PAULO 522 (C) BRASILIA 1299 (D)
BRASILIA 1362

SENSITIVE BUT UNCLASSIFIED

¶1. (SBU) Summary: In response to the global financial crisis, Brazilian President Lula signed Provisional Measure 443 (MP443) October 22 that allows two federal institutions, the Bank of Brazil (BB), and Caixa Economica, the right to purchase stock in Brazilian banks, private or public, as a preventive measure to provide more liquidity to smaller banks in the Brazilian financial system. The BB is also authorized to trade currency directly with other countries' central banks, within the limits and conditions imposed by the National Monetary Council. As the first sign of a legislative challenge to the Lula Administration's handling of the crisis, some in Congress are planning to challenge this measure. Amid concern over possible excess government interference in banking operations, bank sector contacts told Ambassador Sobel that the GOB was "forcing" large banks to take over smaller and medium-sized ones, and that many small and medium banks are suffering more financial distress than official announcements indicate. Along with MP443, President Lula signed a decree which eliminated the federal tax on financial operations (IOF) on financial transactions such as foreign investment in fixed income assets, on foreign loans, and on external financing. The GOB also convened a meeting of regional finance and foreign ministers in Brasilia on October 27 to discuss the financial crisis and options for developing a "coordinated regional response." The President has acknowledged that the financial crisis may require some belt tightening, while affirming continued commitment to PAC infrastructure spending and social programs. END SUMMARY.

¶2. (SBU) Finance Minister Guido Mantega and Central Bank (BCB) President Henrique Meirelles held a joint October 22 press conference to announce Provisional Measure 443 (MP443), which allows federal intervention in private banks in times of crisis without congressional approval. The measure is intended to help small to medium size banks weather the current crisis- a challenge that Central Bank Deputy Governor Alexandre Tombini pointed out during a recent meeting with State Department U/S Reuben Jeffery (REFTEL D). Tombini said that many of the financial products that small and medium size banks offer, such as auto financing and consumer credit), were in jeopardy, threatening domestic demand growth, a key driver of Brazil's economic performance. The press has reported that Finance Minister Guido Mantega called Treasury Secretary Henry Paulson and Central Bank (BCB) President Henrique Meirelles called Fed Chairman Ben Bernanke to discuss the measure before it was announced.

¶3. (SBU) Local reactions to MP443 have been mixed. BB and Caixa reacted favorably as MP443 will facilitate BB's pending negotiation/purchase of Brazilian bank Nossa Caixa. The measure also opens the door for Caixa to engage in sectors that it had not

previously participated in, such as auto finance. Negative commentary from sector observers and opposition politicians has ranged from the concern over expanding public sector intervention and "nationalizing" parts of Brazil's financial system to the measure's lack of transparency. More specifically, some commentators worry that permitting government-owned Caixa to purchase shares of construction/real estate companies poses a risk to that industry. The political opposition has focused on the apparent inconsistencies between this action and repeated government statements that no Brazilian bank is currently at risk of collapse. Several opposition congressmen have criticized Minister Mantega's congressional testimony only the day before the measure was announced, in which he indicated that the steps provided for under the measure were not under consideration by the government. Brazil's congress, led by Senators Francisco Dornelles and Tasso Jerreissati, is considering legislative steps to limit the scope of MP 443, perhaps requiring a timeline for reselling any shares purchased under 443 authority or excluding some private bank shares from being purchased by either BdB or Caixa, or perhaps even challenging its constitutionality. Brazil's construction industry issued a statement criticizing MP 443, stating the industry needs liquidity but does not welcome ownership by public sector banks which could slow the industry's recovery since BdB and Caixa are prohibited by MP 443 from any lending to firms in which they hold an equity position of 10 percent or more.
¶4. (SBU) Ambassador Sobel met with Daniel Goldberg, Morgan Stanley's Head of Mergers and Acquisitions and Country Manager for Brazil, on the day MP443 was announced. According to Goldberg, BB and Caixa were being "forced" by the Central Bank to buy the loan portfolios of the struggling small and middle market banks to reassure the marketplace and provide liquidity. Contrary to GOB claims that no Brazilian banks are currently at risk, Goldberg

stated that Morgan Stanley had received three calls in the past week for "emergency" sell-side mandates for mid-sized banks. He also stated that all banks in Brazil were being asked to disclose their on and off-shore derivatives exposure to regulatory authorities. (Comment: Prior to joining Morgan Stanley, Goldberg was the head of the Secretariat of Economic Law within the Ministry of Justice and reviewed transactions to ensure compliance with Brazilian anti-trust laws. He maintains high- level contacts within the Brazilian Government and, specifically, with Henrique Meirelles (strictly protect). Goldberg stated that when he received the calls for the sell-side mandates, he immediately called the BCB to alert them to the growing problem. End Comment.)

¶5. (U) The elimination of the IOF on certain international transactions in Brazil represents an effort by the GOB not only to stimulate foreign investment in Brazil, but also to head off the recent capital flight that contributed to the depreciation of the Brazilian currency. The depreciation of over 60 percent against the dollar over the past three months has made imports more expensive and has dampened Brazilian domestic growth. The BCB has several mechanisms available to manipulate the exchange rate, ranging from buying and selling USD, to temporarily buying and selling USD through loans with fixed sell/buy back dates, to offering derivatives. The BCB had been buying USD to build up foreign reserves and recently disclosed that it currently has USD 50 billion available for derivatives. This intervention coupled with the elimination of the IOF, is an effort to stabilize the exchange rate and to stimulate domestic growth. Market analysts warn that the elimination of the IOF will result in lower federal revenues and could be a factor in the shifting economic fortunes of Brazil that could possibly force the GOB to alter its spending priorities for
¶2009.

¶6. (SBU) President Lula has publicly acknowledged that if federal tax collections drop, as forecasted by many local economists, the GOB would need to trim the 2009 budget and re-examine federal spending priorities. Previous public statements by Lula and prominent administration members, such as Chief of Staff Dilma Rouseff, have affirmed continued commitment to Growth Acceleration Program (PAC) infrastructure spending and to social programs. On October 3 in Brasilia, Luiz Melin, Chief of Staff to Minister Mantega, told State Department U/S William Burns that Brazil would

not repeat past mistakes in cutting infrastructure investment as it seeks financial discipline, a past approach which, according to Melin, has put Brazil at a disadvantage in terms of global trade competitiveness and domestic economic growth potential.

¶7. (U) The GOB convened a meeting of regional finance and foreign ministers in Brasilia on October 27 to discuss the financial crisis and options for developing a "coordinated regional response." The morning discussion included Brazil, Argentina, Paraguay, Uruguay, and Venezuela, joined in the afternoon by Bolivia, Chile, Colombia, Ecuador, and Peru. While the group agreed further integration was key in addressing global stability and pressed for a transparent international approach, GOB was unable to gain consensus on a joint statement explicitly rejecting protectionism (see septel - communiqu e-mailed to WHA/EPSC and EEB/OMA).

¶8. (SBU) COMMENT: In enacting these measures, Brazil continues to illustrate a pragmatic approach in addressing the global economic crisis, albeit with a sense of concern, but not panic. Although described as a preventive measure, Provisional Measure 443 is a departure from the non-interventionist language used by the GOB until only very recently. Coupled with other measures to pacify regional anxiety and to stimulate domestic spending and foreign investment, the GOB appears to be reassessing the potential impact of the crisis and recalibrating its message accordingly. END COMMENT.

¶9. (U) This cable was coordinated with Consulate Sao Paulo and the U.S. Treasury Attache in Sao Paulo.

SOBEL